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December 16, 2008

AGENDA ITEM 11

TO: MEMBERS OF THE BENEFITS AND PROGRAM ADMINISTRATION COMMITTEE

I. SUBJECT: Proposed Amendments to Regulations for Risk Pools

II. PROGRAM: Retirement

III. RECOMMENDATION:

Staff recommends that the Committee recommend approval by the Board of Administration of publication of the following proposed regulations changes. These proposed changes modify the criteria under which contracting agencies with less than 100 employees may participate in a risk pool, and specify an effective date for benefits mandated by pooling.

- Amend § 588.1 to clarify the effective date of the pool's mandated benefits for plans participating in risk pools.

- Amend § 588.2 to provide staff with the authority to place a new contracting agency in an individual non-pooled plan rather than in a risk pool if CalPERS actuarial staff deem its necessary to protect pooled employers from potential unfavorable additional costs attributable to new contracting agencies.

IV. ANALYSIS:

Since 2003, the Board has had authority to create, combine or eliminate risk pools for local miscellaneous and local safety members. The Board may establish by regulations, the criteria under which contracting agencies and school employers may participate in risk pools.

Beginning with the June 30, 2003 actuarial valuations, plans with less than 100 active members have been mandated into risk pools based on their benefit formula and membership category. There are currently 10 public agency risk pools.

Currently, Government Code Section 20840(e) requires that each risk pool must contain the following benefits:

- Pre-retirement Optional Settlement 2 Death Benefit (Section 21548)
- Credit for Unused Sick Leave (Section 20965)
- Public Service Credit for Periods of Layoff (Section 21022)
- Public Service for Peace Corps or America Corps: VISTA Service (Section 21023.5)
- Military Service Credit as Public Service (21024)
- Public Service Credit for Service Rendered to a Nonprofit Corporation (Section 21026)
- Military Service Credit for Retired Persons (Section 21027)
- Local System Service Credit Included in Basic Death Benefit (Section 21536)
- Cancellation of Payments for Service Credit Purchase Upon Industrial Disability Retirement (Section 21037) (Mandated for all contracting agencies effective 1/1/2004)

Current regulations require any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date to participate in a risk pool. The sharing of risk resulting from participating in a risk pool begins on the day after the date of the actuarial valuation. For an employer required to participate in a risk pool based on the June 30, 2007 actuarial Valuation, risk is being shared beginning on July 1, 2007. However, the date a rate plan starts participating in a risk pool and shares risk with other rate plans of the same pool is different from the effective date of the pool's mandated benefits.

Because of the complexity and the amount of time needed to obtain the information for each individual participant that is required to perform an actuarial valuation, there currently is a two year lag for public agencies between the valuation date of an actuarial valuation and the effective date of the new employer contribution rates established by that valuation. For example, the June 30, 2007 actuarial valuations that were recently completed by the actuarial staff were used to establish the employer contribution rates for fiscal year 2009-2010.

The proposed amendment to regulation 588.1 would codify the existing practices and clarify that even though an employer begins sharing the demographic risk with other plans of the same risk pool as of the date that participation is mandated, the mandated employee benefits will become available to employees only when the employer's contributions to the risk pool reflect the increased costs of the benefits. Thus, in accordance with current time frames, employees of an employer that are required to join a risk pool on June 30, 2007 would not be covered by the risk pool's mandated benefits nor would employer begin to contribute toward the risk pool's mandated benefits until July 1, 2009.,

This is not a change from existing practices. The approach has been used since the implementation of pooling. Attempting to make mandated benefits effective as of the date of the actuarial valuation is impractical because twelve months or more elapse between the valuation date and completion of the actuarial valuations when CalPERS first becomes aware that the active member count has fallen below 100 active members. (i.e. the actuarial valuations as of June 30, 2007 were completed in October 2008.) Making the effective date of the mandated benefits the date of the actuarial valuation would require the pool's mandated benefits to be administered retrospectively causing great administrative difficulty. Meanwhile, the contracting agency is not required to start making contributions for the mandated benefits until the start of the following fiscal year.

For ease of administration of risk pools and fairness among all employers of the same risk pools, the recommendation is to amend § 588.1 to codify current practices and to clarify the Mandated Benefit Effective Date for plans participating in the risk pools as the first day that the agency is required to pay for the mandated benefits. The proposed language for § 588.1 can be seen in Attachment I.

In addition, staff seeks authority to amend § 588.2, upon making specified findings, to place a new contracting agency in an individual non-pooled plan rather than in a risk pool for the purpose of protecting pooled employers from unfavorable additional costs attributable to new contracting agencies.

Current regulations require participation in a risk pool by new contracting agencies if the agency has less than 100 active members at the time of the initial actuarial valuation. This absolute requirement to participate in a risk pool may prove detrimental to existing contracting agencies in a pool if the new contracting agency's retirement benefit costs are significantly higher than those of the pooled agencies. If the new agency's costs are higher than costs of employers in the pool, the employers in the pool will be harmed because they will be paying increased contributions covering amounts for which the new agency was previously responsible.

The proposed amendment to regulation 588.2 would provide an exception to the requirement that new contracting agencies with less than 100 active members would be mandated to join a risk pool. Specifically, if the CalPERS' actuary finds that it would be unfavorable to other agencies in the pool, the new contracting agency would not be included in the risk pool but would be in its own independent pool. The amendment provides that the matter may be referred to the Board for a hearing if such a finding is made. The discretion to preclude an agency's participation in a public agency risk pool is already provided with respect to optional participation in risk pools (See regulation section 588.3).

Recently, the Actuarial Office has performed new contracting agency actuarial valuations for employers currently participating in a 1937 Act County Retirement System. As a result of different actuarial assumptions applied by CalPERS, some of these valuations have revealed that the new contracting agency's employer contribution rates were significantly higher under the County Plan than they would be under CalPERS. These dramatically different employer contribution rates given by CalPERS and other retirement systems result from application of different actuarial assumptions to actuarial valuations.

Generally speaking, it takes several years to identify a plan's true experience on salary growth and various decrement rates. For example, a new group may have a very different salary scale compared with CalPERS plans. Therefore, to avoid potential dispute by new contracting agencies, preserve the actuarial soundness of risk pools and ease the administration of risk pools, we recommend that regulation § 588.2 be amended to allow CalPERS actuarial staff to deny participation in a risk pool if the actuary finds that participation would be unfavorable to the pool and its participants. Upon a finding that participation would be unfavorable, the matter may be referred to the Board for a hearing for determination. The proposed amendment adds the same language that already is included in Regulation 588.3 relating to optional participation.

The proposed amendment can be seen in Attachment I.

If Board approval is received, the regulation adoption process requires:

- Publication in the California Regulatory Notice Register;
- A 45 day public comment period;
- Final Board approval;
- Transmission to the Office of Administrative Law for filing with the Secretary of State and publication in the California Code of Regulations.

The new regulations will become effective 30 days after filing with the Secretary of State. If no changes are made to the regulations during the public comment period, Sections 588.2 and 588.11 could take effect in the summer of 2009.

V. STRATEGIC PLAN:

Amending § 588.1 and § 588.2 regulations support Goal V. of the CalPERS' Strategic Plan. The strategic goal V. reads as follows:

> Provide sustainable pension benefit products and services responsive to and valued by members, employers, and stakeholders.

RESULTS/COSTS:

The adoption of the proposed amendments on **§** 588.1 and **§** 588.2 regulations will not result in additional costs.

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BPAC AGENDA ITEM 11

PROPOSED AMENDMENTS TO REGULATIONS FOR RISK POOLS

Attachment 1

Proposed Amendments to Article 7.6 of Chapter 2 of Division 1 of Title 2 of the California Code of Regulations

Attachment I

PROPOSED AMENDMENTS TO ARTICLE 7.6 OF CHAPTER 2 OF DIVISION 1 OF TITLE 2 OF THE CALIFORNIA CODE OF REGULATIONS

§ 588.1 Risk Pools – Required Participation for Existing Contracting Agencies

Following the creation of risk pools pursuant to Section 20840 of the Government Code, any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date shall be required to participate in a risk pool. Participation shall be effective as of that valuation date for all members of that rate plan, but no earlier than the June 30, 2003 actuarial valuation which will be used to set employer contribution rates for fiscal year 2005-2006. *The effective date of the pool's mandated benefits pursuant to §20840 of the Government Code for contracting agencies who participate in a risk pool is the first day that the agency is required to pay for the mandated benefits.*

NOTE: Authority cited: Sections 20120, 20121 and 20840, Government Code. Reference: Section 20840, Government Code.

§ 588.2 Risk Pools – Required Participation for New Contracting Agencies

A new contracting agency with CalPERS following the creation of risk pools shall be required to participate in a risk pool if the number of active members in the rate plan is less than 100 at the time of the initial actuarial valuation *provided that the actuary determines such participation will not be unfavorable to other agencies in the pool. In the event that such participation would be unfavorable, the matter may be referred to the CalPERS Board for a hearing.*

NOTE: Authority cited: Sections 20120, 20121 and 20840, Government Code. Reference: Section 20840, Government Code.